

Statement of Benjamin F. Miller
for the
Hearing On Proposed Amendments to Article IV
of the Multistate Tax Compact
Washington D.C.
March 28 and 29, 2013

My name is Benjamin F. Miller, I appear at this hearing today as an individual who has worked for over 40 years as a tax attorney for a state that adopted the Uniform Division of Income for Tax Purposes Act (UDITPA) in 1967. My appearance today is not on behalf of any state or any client. It is motivated by the fact that my professional life has been devoted to the subject matter of UDITPA. The comments and opinions expressed herein are solely my own. I have not consulted with any individual with respect to these comments and opinions. Specifically I would like it to be noted that I am not speaking on behalf of, or as a representative of, the California Franchise Tax Board or any member of the staff of that agency.

I am a Certified Tax Specialist in California and a member of the California Bar's Tax Law Advisory Commission. I have lectured and taught about state income tax principles in a variety of forums. I have served as a consultant to a variety of states and appeared as an expert witness. I am one of three named authors on CCH's Expert Treatise Library: State Taxation of Income and Other Business Taxes. My contributions in the area of state taxation of multistate businesses have been recognized by the Multistate Tax Commission, the Federation of Tax Administrators and various committees and subdivisions of the bar of the State of California.

For most of my professional life I have been involved in the presentations to the United States Supreme Court of issues regarding the division of income between the states either as a party or as an amicus. I have been a principal draftsman of legislation and regulations involving the determination of and assignment of the income of multistate businesses to an individual state, including the implementation of UDITPA. I have been involved in the activities of the Multistate Tax Commission for many years as a member of the Litigation Committee, the Uniformity Committee and as a representative of a state to both the Commission and the Executive Committee of the Commission. I was a participant in the drafting of the proposed amendments that are the subject matter of this hearing.

UDITPA

The Uniform Division of Income for Tax Purposes Act (UDITPA) was promulgated in 1957. UDITPA was an effort by the Commissioners on Uniform State Laws to promote uniformity in state laws regarding the division of income of businesses conducted in more than one state. It served as a model for such laws in over 35 states and achieved a significant degree of uniformity.

UDITPA, however, was designed for a different and, almost assuredly, simpler economic and business environment. As time has past states have departed from its provisions in response to the different ways in which business has been conducted and by the desires of the states to encourage economic development. Some parts of UDITPA remain in place but in other areas there have been departures by the states so it no longer reflects the practices of a majority of the states or serves the purpose of promoting or reflecting uniformity . It is time to revisit UDITPA and to bring it into conformity with the practices of the majority of the states.

MY CRITERIA FOR EVALUATING PROPOSED CHANGES

There are six principles which I believe were involved in the original drafting of UDITPA and which I believe have continuing vitality for purposes of considering changes.

State taxation of multijurisdictional taxpayers is subject to Constitutional limitations, principally the Due Process Clause of the Fourteenth Amendment. The unitary business principal is the constitutional touchstone.¹

The income of a multijurisdictional business is difficult, if not impossible, to precisely assign geographically or functionally. As Justice Brennan said, assigning income is akin to slicing a shadow.² As a result, precision is not possible and all that is required of the methods is a rough, but fair, approximation.

There should be full accountability. That is, 100 percent of the business's income should be assignable to a jurisdiction that can tax it. While from some perspectives it might be simpler if the rule of full accountability were satisfied only when actual taxation existed, that is not required. States should be allowed to not assess tax if they determine that is appropriate. This should not provide justification for other states to tax such income.

The factors in an apportionment formula is not what is being taxed. The factors are only a means to measure activity, which in turn is used to assign income. Not every activity needs to be reflected in the formula and not every possible item that fits within a factor needs to be included.

The method, both in terms of calculation and application, must be administrable. It is self-defeating to pick the most accurate measurement of activity or an activity if the information to make the calculation is not readily available.

Uniformity by itself can be a solution to many problems. Issues of under-taxation or over-taxation are addressed by uniformity. With uniformity, what is over-

¹ *Mobil Oil Corporation v. Vermont* (1983) 425 U.S. 445, 439

² *Container Corporation of America v. Franchise Tax Board* (1980) 463 U.S. 159, 192.

taxed in one jurisdiction will be commensurately under-taxed in another jurisdiction if all jurisdictions use the same rule and the test of internal consistency³ is met.

PROPOSED CHANGES

There are five proposed changes that address four basic areas. The areas are 1) what income is subject to assignment by apportionment (Business Income, Art. IV.1.(a) and Nonbusiness income, Art. IV. (e)) ; 2) the sales factor with two subparts, what are sales (definition of sales, Art. IV.1.(g)) and how to assign sales other than those involving the sale of tangible property (Art. IV.17); 3) factor weighting (Art. IV.9); and 4) the use of alternative apportionment methods (Art IV.18).

BUSINESS NONBUSINESS INCOME

Art. IV.1.(a) and (e)

The proposed changes involve 1) changing the word "business" to "apportionable" in Art IV.1.(a) and Art. IV. 1.(e), 2) including reference to Constitutional requirements for apportionability 3) recognizing that income that could be Constitutionally allocated, assigned to a single state, can be treated as apportionable by the state, 4) affirming that the tests for apportionment include both a transactional and a functional component, and 5) providing further explication of the functional component.

The first problem in this area, proposed changes Art. IV. 1.(a) and (e), seems to be engendered by the title attached by UDITPA to the type of income, Business or Nonbusiness. This has been particularly apparent in those cases involving the classification of gain or loss on the cessation of business or the sale of going business by its owner. I agree with and endorse the replacement of the word "business" with "apportionable." **This change should promote uniformity.**

With respect to the second item, proposed change Art. IV.1.(a)(i), I recognize that that a state's right to subject an item of income to apportionment is governed by the Due Process Clause of the Fourteenth Amendment of the Constitution under the jurisprudence of the United States Supreme Court. This change reflects reality. **It is consistent with the analysis promulgated by the United States Supreme Court.**

I, nonetheless, would reject a definition of apportionable income referencing Constitutional principles. I do not believe that such a standard provides any real guidance. Determinations under the Due Process Clause are inherently fact related. The Constitutional standard would be subject to continual change based upon the vagaries of the facts of the most-recently litigated case.

An illustration of this is the decisions of the United States Supreme Court in *Mobil Oil Corp. v. Vermont*,⁴ *ASARCO, Inc. v. Idaho State Tax Comm'n*,⁵ and *Allied Signal Inc. v.*

³ A tax is internally consistent if no more than 100 percent of the income was taxed if every jurisdiction applied the same rules. *Container, supra*, at 169.

*Dir., Tax'n Div.*⁶ In *Mobil* the court held that dividends from the ownership of a minority interest in a related entity were apportionable income. In *ASARCO* the Court held that dividends from non-controlling interests in entities that were not combinable were not apportionable. In *Allied-Signal* the Court referred to its analysis in *ASARCO* that only dividends from combinable entities was a "foot-fault."

A standard for apportionability based solely upon Due Process analysis would not provide firm guidance to either taxpayers or tax administrators. Such a standard would provide a prescription for continuing and unending litigation. **This change raises concerns about administerability and uniformity.**

With respect to the third item, proposed change Art. IV.1.(a)(ii), I support this change. This proposed change recognizes that with respect to a particular item of income that a state could Constitutionally choose to allocate, assign it to itself and tax accordingly, it may choose to forgo that choice and include the item of income in apportionable income. By choosing to apportion such an item of income which other states could only apportion it promotes uniformity. An argument can be made that, in the interests of uniformity, if an item of income could be apportioned by any state then all states should apportion it. Such a provision, however, would impinge upon state sovereignty and is not Constitutionally required. **This change promotes uniformity.**

With respect to the fourth item, proposed changes dividing Art. IV.1.(a)(i) into subparts (A) and (B), I strongly support this change. These changes make it clear that there are two separate tests for determining apportionable income the transactional test and the functional test. **This change promotes uniformity.**

This change reflects the position of most states. There is now general agreement as to what should be apportionable income and general acceptance that it should be a broad definition. The states that have formally indicated that they recognize both a transactional and functional test are: Alabama,⁷ Alaska,⁸ Arkansas,⁹ California,¹⁰ Florida,¹¹ Georgia,¹² Hawaii,¹³ Idaho,¹⁴ Indiana,¹⁵ Iowa,¹⁶ Kansas,¹⁷ Kentucky,¹⁸

⁴ 445 U.S. 425 (1980)

⁵ 458 U.S. 307 (1982).

⁶ 504 U.S. 768 (1992)

⁷ Sec. 40-27-1.1

⁸ [AS 43.19.010 Art. IV\(1\)\(a\)](#) ; [15 AAC 19.011\(a\)\(1\)](#)

⁹ [Sec. 26-51-701\(a\), A.C.A.](#)

¹⁰ *Hoechst Celanese Corp. v. Franchise Tax Board* (2001) 25 Cal.4th/ 508, 532

¹¹ Florida has not adopted UDITPA but has adopted the transactional and functional test for determining business income. [Rule 12C-1.003](#)

¹² Georgia treats all income as apportionable except for certain types of income that are allocable. The Georgia view is broader than business income under UDITPA

¹³ [Haw Rev Stat Sec. 235-21](#)

¹⁴ [IC Sec. 63-3027\(a\)](#) ; [Rule 35.01.01.331.01](#)

¹⁵ [IC 6-3-1-20](#) ; [45 IAC 3.1-1-29](#) ; [45 IAC 3.1-1-30](#) ; *The May Department Stores Company v. Indiana Department of Revenue*, 749 N.E.2d 651 (2001)

¹⁶ [Sec. 422.32\(1\)\(b\), Code of Iowa](#)

Mississippi,¹⁹ Missouri,²⁰ Montana,²¹ New Jersey,²² New Mexico,²³ North Dakota,²⁴ Oregon,²⁵ Tennessee,²⁶ Utah,²⁷ Vermont²⁸ and West Virginia.²⁹

State courts have wrestled with business/nonbusiness classification issues and the UDITPA definition for more than four decades with decidedly mixed results. There appears to be little controversy that income arising from the day-to-day operation of the business should be apportioned. The areas of controversy largely involve income that is generated from ancillary activities or from the disposition of the assets that were used in the operating business. Court decisions discuss whether the wording of the UDITPA definition includes two independent clauses, transactional and functional, or one clause, transactional, with a subordinate clause.

In several of the states where courts have construed the UDITPA definition as including only a transactional test, there has been a relatively immediate legislative response to broaden the definition. Unfortunately, in some jurisdiction this response has been one-sided; domiciliaries are able to elect to treat most items as apportionable income and non-domiciliaries can elect to treat contested items as allocable. **This does not promote uniformity but recognizes the sovereign character of states.**

Finally, with respect to the fifth item, proposed change Art.IV.1.(a)(i)(B), I strongly endorse these changes. These changes provide additional clarification as to what constitutes income that is apportionable under the functional test. In particular, the proposed change makes it clear that income arising on the disposition of property that is or was an asset of a unitary business gives rise to apportionable income. The majority of the disputes in state courts have arisen on the disposition of assets that were used in the business and, in particular, when the assets were disposed of in terminating a line of business or activities in a state. From my perspective, there are several compelling justifications for treating the results of these dispositions as apportionable income. The expenses related to such assets were taken into account in determining apportionable income in preceding years. The assets involved have been reflected in the apportionment

¹⁷ [Sec. 79-3271\(a\), K.S.A.](#) That section also allows a taxpayer to elect to treat all income as business income

¹⁸ [103 KAR 16:060](#)

¹⁹ [Miss Code Ann Sec. 27-7-23\(a\)\(2\)](#) ; Miss Reg. 35.III.8.06 301

²⁰ [12 CSR 10-2.075](#)

²¹ [Gannett Satellite Information Network, Inc. v. Montana Department of Revenue](#), 348 Mont. 333, 201 P.3d 132 (2009)

²² New Jersey divides income into operational and nonoperational and then applies the transactional and functional tests to make the classification. Instructions, Schedule O, New Jersey Nonoperational Activity Packet

²³ [NM Stat Ann Sec. 7-4-2\(A\) \(1978\)](#)

²⁴ [Sec. 57-38.1-01\(1\), NDCC](#) ; [Rule 81-03-09-03, NDAC](#)

²⁵ [OAR 150-314.610\(1\)-\(A\)](#)

²⁶ [Sec. 67-4-2004\(3\), T.C.A.](#),

²⁷ [Rule R865-6F-8\(2\), Utah Admin. Code](#)

²⁸ [32 V.S.A. Sec. 5833](#). Vermont does not follow the normal business/nonbusiness rules, nonbusiness income is generally limited to passive or portfolio income.

²⁹ [W.Va. Code Sec. 11-24-3a\(a\)\(2\)](#)

formula for years. Finally, the sale or disposition of assets reflects the final culmination of business activities. **This change will promote uniformity.**

SALES FACTOR

DEFINITION OF SALES

Art. IV.1.(g)

The sales factor as originally contemplated in UDITPA was intended to represent the contribution of the market to the earning of income. As such the sales factor should reflect activities of the taxpayer with its customers. The current broad all encompassing definition of sales defeats the purpose of the sales factor.

The Multistate Tax Commission (MTC) has proposed a regulation defining gross receipts for purposes of the sales factor that would exclude such proceeds and a number of other items from the sales factor.³⁰ The proposed changes to the statutory definition of sales conforms to the MTC's proposed regulation.

The problems with the overly broad definition of sales is illustrated by cases that have been and or are currently being litigated. These cases reflect efforts to inflate the denominator of the sales factor. Interestingly these efforts to inflate the denominator of the sales factor have only been made in those states where the activity would not be included in the numerator of the sales factor. **If successful these efforts result in "nowhere" income in violation of one of the basic premises of UDITPA.**

The earliest effort in this area involved the question of whether proceeds from the short-term investment of liquid assets should be included in the denominator of the sales factor. This issue was first raised in the seventies and appeared to be put to rest by a series of decisions involving AT&T. It resurfaced in California in the nineties as the result of a decision involving a securities dealer.³¹ California defended these cases on two grounds. First, the return of principal when these short-term investments are held to maturity does not constitute a gross receipt, and, second, that including such proceeds in the sales factor does not fairly represent the extent of the taxpayer's activity in California. The first ground was rejected by the California courts on the basis that these receipts were encompassed by the UDITPA definition of sales. The determination of this question varied between the states. California was generally successful in avoiding this attempt at denominator inflation under its powers under Section 18 of UDITPA.³² Other states

³⁰ MTC reg. IV.2 (a)(5).

³¹ Appeal of *Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, California State Board of Equalization, 89-SBE-017 (1989).

³² *General Motors Corporation v. Franchise Tax Board*, 39 Cal. 4th 773, 47 Cal. Rptr. 3d 233, 139 P.3d 1183 (2006); and *Microsoft Corporation v. Franchise Tax Board*, 39 Cal. 4th 750, 47 Cal. Rptr. 3d 216, 139 P.3d 1169 (2006).

which have not been successful defending against this denominator inflation by the definition of sales have also been successful under Section 18.

California recently had a case involving an attempt to inflate the denominator of the sales factor by including the receipts from hedging activity of commodities.³³ Other variants of the this strategy involve including hedging of foreign currency transactions. Section 18 has been used to combat these efforts at denominator inflation.

Another example of a strategy to inflate the denominator of the sales factor was presented in the case of *Union Pac. Corp. v. Idaho*.³⁴ In that case, Union Pacific included in the sales factor the receipts it generated from providing transportation services, and then attempted to include the receipts it generated from selling the receivables arising from providing transportation services. Idaho successfully thwarted this strategy by arguing that such treatment would not fairly reflect the taxpayer's activity in Idaho.

Reliance on Section 18 does not promote uniformity. A better solution than having to rely on section 18 of UDITPA would be to define sales more narrowly. The proposed amendment to the definition of sales adopts this approach. **This promotes uniformity and protects against "no-where" income.**

The argument is frequently made that if an item is classified as business income, it must be in the sales factor. I believe this argument is incorrect. It appears to be based upon the underlying assumption that the factor itself is being taxed. The United States Supreme Court has rejected this type of argument.³⁵ If the definition of sales were limited to include only sales to customers in the normal course of business, the purpose of the sales factor to represent the market would be fulfilled, and issues arising from other types of sales would be eliminated. If additional receipts need to be counted, then including interest income and net gains and losses on the sales of intangibles should provide sufficient weight in the sales factor for all but financial corporations or brokers. **Limiting the definition of what is included in the sales factor will result in a more accurate reflection of the intended purpose of the sales factor.**

SALES OF OTHER THAN TANGIBLE PROPERTY

Art. 17

Under UDITPA the sales factor was to be a balance to the property and payroll factors, which represented the contributions of capital and labor respectively. Under UDITPA, the sales of tangible property are assigned generally to the location of the customer, where the market is for the goods. For all other receipts UDITPA treats those receipts as sales and assigns those sales to the state of principal income- producing activity.³⁶

³³ *General Mills, Inc. v. Franchise Tax Board*, 146 Cal.Rptr.3d 475, 208 Cal.App.4th 1290 (2012)

³⁴ *Union Pac. Corp. v. Idaho State Tax Comm'r* (2001) 136 Idaho 34; 28 P.3d 375.

³⁵ *Trinova Corporation v. Michigan Department of Revenue* (1991) 498 US 358.

³⁶ Section 17.

Income-producing activity involves either the employment of property or individuals. It replicates the property and payroll factors. It does not represent the market. **Changes in Art. IV.17 to represent the market are appropriate and will better reflect the intended purpose of the sales factor.**

All-or-Nothing Assignment

A problem with respect to the assignment of sales of other than tangible property is the all or nothing rule of UDITPA. These sales are assigned to the state with the preponderance of income-producing activity.³⁷ Not only is there no division of the sales between states, but also strict application of this rule could result in the total sales being assigned to a state where 2.1% of the activity occurred if the remaining 97.9% of the activity was divided evenly among the other forty-nine or fifty jurisdictions. A number of states have departed from the UDITPA rule and provide for a proportional assignment of sales while retaining assignment pursuant to income producing activity. Other states have abandoned the use of income producing activity to assign such receipts and use assignment rules such as the "point of delivery" or "where the benefit is received." Finally, other states have dealt with this issue through the use of their powers under Section 18 of UDITPA. The MTC's current regulations in this area provide a partial solution to this problem by stating that when the activities occur within and without the state, the activities in each state will be considered a separate income producing activity.³⁸ **Abandoning the all-or-nothing assignment rule will allow the sales factor to better reflect the market and will promote uniformity.**

Other Receipts from Tangible Property

The sales covered by Art. 17 include a variety of receipts, everything that is not covered by Art. 16. Art. 16 deals only with the sales of tangible property. Art. 16 does not deal with other receipts generated from tangible property both real and personal, such as rents. Art. IV.17 covers receipts from tangible property other than actual sales. These receipts include the leasing of tangible property, both real and personal. Many of the receipts generated by such activities had traditionally been treated as income that was specifically allocated to a single jurisdiction under the MTC regulations. Those assignments have generally been accepted but are subject to challenge as not being contemplated by the statute. The changes proposed in ArtIV.17(a)(1) and (2) incorporate the rules included in the current regulation. I strongly endorse these changes.

Receipts not Involving Tangible Property

Art. 16 does not apply to receipts from intangibles and it does not apply to receipts from the providing of services. When UDITPA was promulgated, sales, other than sales of tangible property were not significant. Such sales represented a minority of the sales of

³⁷ Section 17(b).

³⁸ MTC reg. IV.17.4 (B)(c).

business generally. Our economy has changed in 50 years, and receipts other than from the sale of tangible property represent the majority of the sales of the United States and world businesses. If the sales factor is to represent the market the UDITPA rules in this area need to be revised to reflect the location of the customer who is purchasing the service or the intangible. **Changing the assignment rule for receipts from intangibles will better reflect the purpose of the sales factor.**

Receipts from Services

The changes in Art.IV.17.(a)(3) assign receipts from services to the extent the service is delivered to a location in a state. I strongly endorse changes that make the assignment of receipts from providing services on a market basis. **This change will reflect the purpose of the sales factor, reflection of the market.**

The choice of a standard by which to make a market assignment, however, is difficult. Delivery can be an imprecise term in some circumstances but it is information that should be available to the taxpayer. If services are rendered to a multistate business there may be issues as to where they are delivered. Is it the home office of the business, or a particular location of the business? If the latter it may be apparent from a contract or a mailing address. If the location to which it is delivered is a home office and the service relates to something that occurs in only one location or a different location that may not accurately reflect the market. As an example, if the home office of a multistate business asks for legal advice from a national law firm regarding tax matters in a state other than where the home office is located where does "delivery" occur.

An alternative standard for assigning such sale might be "where the benefit of the service is received." This standard has been adopted by a number of states. That standard may also be difficult to apply in many cases and, most importantly, may require a determination on the basis of information that is not available to the taxpayer. Assignment based on delivery may be the best that can be done. It should be information that is available to the taxpayer. **Use of delivery is consistent with administrability.**

Receipts from Intangibles

Art. IV.17.(a)(4) deals with the assignment of receipts from intangible property. It breaks the receipts into two classes. Subparagraph (i) assigns receipts from the rental, leasing or licensing of an intangible to the extent the property is used in this state. Subparagraph (ii) assigns receipts from the sale of intangible to the state where it is used with two additional subparagraphs dealing with particular sales transactions.

With respect to receipts from intangibles, other than from sales, where the intangible property is used reflects the market and is similar to the current rule for the allocation of such receipts from intangibles which constitutes what UDITPA presently calls nonbusiness income.

The rule utilizes proportionality. The use of the property in this context would typically be continuing so where it is used may vary over time. Issues may arise with respect to a taxpayer knowing the place where an intangible is used. It is fairly common, however, for a taxpayer to have the ability to audit the use of an intangible to ensure that it is receiving proper compensation of its use. This ability should allow it to determine where use occurs. **The standard meets the criteria of administerability.**

With respect to sales of intangible property there is typically no continuing responsibility to make payments. The ability to make a determination where property is used at the point of time of the sale should generally be determinable. A special rule is provided in subparagraph (B) for sales where the price is dependent on continuing use. Again a taxpayer's ability to audit records to determine the actual continuing use should allow for the determination of where that use occurs. A special rule is also provided with respect to a franchise or license is set forth in subparagraph (A) which is specifically tied to the geographic area covered by the agreement. **The rules meet the criteria of administerability.**

The difficulties with administration are addressed by Art. IV.17.(b) which allows for the use of approximations if an assignment cannot be made pursuant to Art. IV.17(a). It is hoped that reference to this provision would not occur frequently. It would appear there need to be regulations adopted to implement this provision.

Art.IV.17(c) and Art. IV.(a)(4)(ii)(C) provide a throwout rule if assignments cannot be made by reference to other provisions of Art.IV.17. Specific authority for throwout rule if it is to exist should be provided.

Art.IV.17(d) provides specific authority for the adoption of regulations to implement this and the other provisions. Providing specific authority may raise the level of authority with respect to such regulations, characterizing them in some jurisdictions as being "legislative" actions. **This should promote uniformity and administerability.**

In most cases the specific sourcing rules are workable. It must be recognized that the sourcing of some receipts, in particular those received from multistate entities, maybe difficult to determine precisely. In some circumstances that necessary information may not be readily available to the taxpayer because it is dependent on the uses made of an item by the taxpayer's customer. The use of approximations, while lacking precision, appears to be an appropriate effort to reach a workable result.

The proposed changes to Art.IV.17 are to be commended. The adoption of market based sourcing for the various receipts comports with the purpose of the sales factor and as should abandonment of the all or nothing rule.

FACTOR WEIGHTING

Art.IV.9

UDITPA uses an equally weighted, three-factor formula.³⁹ The UDITPA formula has been referred to by the United States Supreme Court as "something of a benchmark,"⁴⁰ though the Court also indicated that the weighting assigned to the factors is "essentially arbitrary."⁴¹ The UDITPA factors are tangible property, payroll, and sales. But the United States Supreme Court has also accepted single-factor formulas.⁴² Pre-UDITPA formulas included a variety of other activity measurements.

There is nothing sacrosanct about the three factors used in UDITPA, but the United States Supreme Court has stated that the UDITPA formula reflects a rough sense of how income is earned.⁴³ The Supreme Court's jurisprudence requires that an apportionment formula must have "external consistency," that is, the factor or factors used must reflect a reasonable sense of how income is generated.⁴⁴ The equally weighted, three-factor formula clearly passed muster. I believe, from a theoretical perspective, the use of a multi-factor formula is superior to a single-factor formula. The use of multiple factors has the advantage of averaging. That is, anomalies that might occur with respect to a single factor will tend to be offset by the other factors, and the significance of any individual factor will be lessened by the use of other factors.

The states have been moving to a double-weighted, or more, sales factor or a sales factor only apportionment formula. The trend to double weighting the sales factor in the traditional three-factor formula has some justification in that the sales factor represents the "market" and the property and payroll factors represent the production side of the income equation. The use of a sales-only apportionment factor, however, seems suspect. An example I have frequently used to demonstrate the problem which a sales factor formula only is a two-state oil company that has wells in one state, A, and sells the product in another state, B. In a sales factor only environment all the income would be assigned to state B. This result seems unreasonable and would be unlikely to survive a constitutional challenge. Arguments have also been raised that the apparent motivation behind the use of a sales factor only may be constitutionally suspect as being discriminatory.

Given the current trends, it would appear to me that this is an area in which a compromise between theoretical purity and political expediency will have to be made in the interest of uniformity. If uniformity can be achieved, the overall result may be acceptable.

The current proposal seems to contemplate two options. The first is just a statement that apportionable income is to be apportioned by the formula employed by the state. The

³⁹ Section 9.

⁴⁰ *Container, supra*, at 170.

⁴¹ *Ibid.* at 184, fn. 20.

⁴² *Moorman Manufacturing Company v. Bair* (1978) 437 U.S. 267 and *Underwood Typewriter Co. v. Chamberlain* (1920) 254 U.S. 113.

⁴³ *Ibid.* at 186.

⁴⁴ *Ibid.* at 169.

second recommends a double-weighted sales factor. The first option does not mandate uniformity, the second option is already out-of-step with the current trend and is unlikely to achieve uniformity.

I believe a multi-factor formula is the superior approach. The relative weighting of the factors appears to be arbitrary. Double-weighting sales, however, has the attribute of balancing supply and demand.

If uniformity in terms of language is the goal then the first option will achieve a degree of "uniformity" in that every state could adopt it and continue to have flexibility in designing its own formula .

If theoretical purity is the goal then endorsing a multi-faceted formula would be best. I see no theoretical reason that double-weighted sales should, or should not, be the formula of choice.

Given the current trends, it would appear to me that this is an area in which a compromise between theoretical purity and political expediency will have to be made in the interest of uniformity. If uniformity can be achieved, the overall result should be acceptable.

ALTERNATIVE METHODS

Art.IV.18

UDITPA currently provides for variations from the standard provisions if the statutory rules "do not fairly reflect the activity within the state."⁴⁵ Clearly there needs to be a provision for relief from the standard rules. Even if one rule could be written to handle all existing business arrangements and activities, it is unrealistic to expect that such rules would be uniformly appropriate forever. There are, however, a number of questions that arise with respect to such a safety valve.

One issue not addressed by the proposed amendments is whom should have the burden of showing the need for a variation? It appears to be generally accepted that whichever party is seeking to vary should have the burden therefore there may not be a need to address this question. I would suggest making this explicit in the statute.

What is the correct standard? Some have suggested that constitutional distortion should be required. In my opinion, this would be too high a threshold and might require that every request for variation would be resolved through litigation. I would endorse continuing with the current standard or some variation which is the recommendation in the proposed amendment. I would not recommend attempting to establish a specific threshold for determining the need for a variation. Many of the cases involving questions of unfair reflection attempt to perform mathematical analyses. I believe the use of a mathematical standard or threshold would be improper. The question of fairness is one of qualitative relationships, not quantitative ones.

⁴⁵ Section 18.

Should variations be uniform? To achieve an appropriate level of uniformity, variations should be made uniform. This principle of uniform variations could have particular application in the case of apportionment rules for particular industries or to deal with commonly occurring situations, an area that states now deal with through specific statutes or regulations. At least there should be uniformity within a state. This type of uniformity can best be achieved through the formal rule making process of adopting regulations. A presumption of correctness should be attached to a rule adopted through the regulatory process.⁴⁶ The proposed amendments deal with this in Art.IV.18(b)(1) and (2). Subparagraph (2) allows variations from rules adopted by regulation under the general provisions of Art.IV.18(1). **This change will promote uniformity.**

⁴⁶ See *Appeal of Fluor Corporation*, SBE, [95-SBE-016](#), (1995)